

STATE OF NEW YORK

DIVISION OF TAX APPEALS

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In the Matter of the Petitions	:	
of	:	
VITO AND MARIA SALERNO	:	
D/B/A FRAPPOSA ITALIAN RESTAURANT	:	DETERMINATION
AND FRAPPOSA RESTAURANT CORP.	:	
for Revision of Determinations or for Refund	:	
of Sales and Use Taxes under Articles 28 and 29	:	
of the Tax Law for the Period March 1, 1986	:	
through February 28, 1989.	:	

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Petitioners, Vito and Maria Salerno d/b/a Frapposa Italian Restaurant and Frapposa Restaurant Corp., 389 First Avenue, New York, New York 10010, filed petitions for revision of determinations or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period March 1, 1986 through February 28, 1989 (File Nos. 807677 and 808498).

A consolidated hearing was held before Dennis M. Galliher, Administrative Law Judge, at the offices of the Division of Tax Appeals, Two World Trade Center, New York, New York, on March 1, 1991 at 10:15 A.M., with all briefs to be submitted by May 24, 1991. Petitioners appeared by Roy M. Macchiarola, CPA. The Division of Taxation appeared by William F. Collins, Esq. (Robert J. Jarvis, Esq., of counsel).

ISSUES

I. Whether the Division of Taxation properly determined additional sales and use taxes due based upon a field audit of petitioners' business operations.

II. Whether, if so, petitioners have nonetheless established any basis warranting waiver of penalty and/or reduction of interest assessed in connection therewith.

FINDINGS OF FACT

On September 20, 1989, the Division of Taxation issued to petitioners Vito and Maria Salerno d/b/a Frapposa Italian Restaurant, a Notice of Determination and Demand for Payment of Sales and Use Taxes Due for the period March 1, 1986 through February 28, 1988 assessing

tax due in the amount of \$10,548.21, plus penalty and interest. On the same date, the Division also issued a second Notice of Determination and Demand for Payment of Sales and Use Taxes Due assessing omnibus penalty against these petitioners for the period March 1, 1986 through February 28, 1988.<sup>1</sup>

On May 8, 1990, the Division of Taxation issued to petitioner Frapposa Restaurant Corp. a Notice of Determination and Demand for Payment of Sales and Use Taxes Due for the period March 1, 1988 through February 28, 1989 assessing tax due in the amount of \$5,884.64, plus penalty and interest. On the same date, the Division also issued a second Notice of Determination and Demand for Payment of Sales and Use Taxes Due assessing omnibus penalty against this petitioner for the period March 1, 1988 through February 28, 1989.

During the period at issue petitioners Vito and Maria Salerno operated a small restaurant serving primarily pizza, as well as some other Italian dishes such as spaghetti and baked zita.<sup>2</sup>

The assessments in question arose as the result of a field audit of petitioners' business operations which audit commenced in the latter part of March 1989. Pursuant to written requests made by the auditor at the commencement of the audit, records were sought from petitioners and from petitioners' representative. Meetings between petitioners' representative and the auditor, commencing on or about April 24, 1989 and continuing thereafter, revealed that the records maintained by petitioners were insufficient to conduct a detailed audit for the period in question. More specifically, petitioners lacked cash register tapes, sales invoices, guest

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<sup>1</sup>Validated consents extending the period of limitations were executed such that assessment for the period March 1, 1986 through May 31, 1986 could be made at any time on or before September 20, 1989.

<sup>2</sup>For the first period assessed above, Vito and Maria Salerno (son and mother) operated Frapposa Italian Restaurant as an unincorporated entity. Thereafter, in or about March 1988, the business was incorporated. Hence, the assessments described in Finding of Fact "2" are issued to the corporate entity. The audit performed, however, involves a continuation throughout the period in question with separate assessments issued only to reflect the change in the form of ownership.

checks or any other source documents by which the amount of sales could be verified.

Accordingly, the auditor decided to determine petitioners' tax liability by resorting to an indirect audit methodology, more specifically involving a comparison of supplier information on purchases to purchases as recorded on petitioners' Federal income tax returns and those books of account available.

The auditor totalled purchases from petitioners' checkbook for the month of July 1987 (\$1,501.00), plus 1/12th of petitioners' 1987 yearly cash purchases of \$7,650.00 (\$638.00) to arrive at total monthly purchases (books plus cash) of \$2,139.00. This amount for July 1987 was compared to purchases of \$3,268.00 as reported by petitioners' only known supplier for the same month, with the \$1,029.00 difference between these amounts resulting in a purchase error rate of .5278. The auditor concluded that since the ingredients purchased were used

primarily in making pizza, petitioners' main sale item, direct application of the error rate on purchases to reported sales was appropriate to determine unreported sales. Accordingly, applying the .5278 error rate to petitioners' reported sales resulted in a determination of unreported sales and, by application of the appropriate tax rate thereto, resulted in additional sales tax due of \$9,966.83 for the first period in question and \$5,564.21 for the second period in question.

The auditor also requested bills or invoices relating to recurring purchases reported on petitioners' Federal income tax returns. Such invoices, requested for the purpose of verifying that tax had been paid on such purchases, were not provided. Hence, the auditor assessed use tax due on such purchases in the amounts of \$581.38 for the first period in question and \$320.43 for the second period in question.

At hearing, petitioners' representative specified that the method of audit was not in question or challenged, and admitted that petitioners did not maintain sufficient records from which a detailed audit could have been performed. However, petitioners do challenge the resulting amounts of the assessments and also request abatement of penalty and reduction of

interest. Petitioners' arguments center on the assertion that the month used by the auditor (July 1987) was not a statistically representative month vis-a-vis petitioners' business.

Petitioners' representative alleged that petitioners paid for supplies as delivered either during the previous week or in the current week. Petitioners' representative noted that petitioners' purchases by check included in the auditor's test month of July 1987 occurred on July 8th, July 15th and July 22nd in the amounts of \$469.00, \$347.00 and \$685.00, respectively, for a total of \$1,501.00. He also noted that purchases were reflected in petitioners' checkbook as paid for on June 30th and August 18th. Petitioners' representative seeks to reallocate these latter two purchases, in the amounts of \$674.00 and \$585.00 as purchases properly attributable to July 1st (the June 30th payment) and July 29th (the August 18th payment), respectively. He noted that by adding these latter two payments to the auditor's calculation of July purchases results in July purchases of \$3,397.50 which, when compared to purchases reported by petitioners' supplier (\$3,268.00), leaves a much lower margin of error. Petitioners' representative also opined that July was a "slow month" for the business. However, other than noting that petitioner Vito Salerno's mother was seriously ill and living in Europe and that Mr. Salerno was out of the country to visit her in July 1987, no other support for the allegation that July was a slow month was specified.

With respect to the recurring expenses, petitioners' representative argued that such expenses consisted of advertising in the yellow pages, automobile use, utilities, office costs and cleaning. Petitioners' representative alleged that such items as yellow-page advertising and utility bills would automatically have sales tax collected thus leaving no need for the production of invoices for review. In any event, it was admitted that no invoices for such expenses were produced on audit or afterward.

Petitioners did not personally appear or give testimony at hearing. Petitioners' representative has been petitioners' accountant since the business began in 1986, and he noted that, while petitioners admittedly do not keep adequate records, he does the "best he can" in preparing petitioners' records and tax returns.

### CONCLUSIONS OF LAW

A. There is ample support via statute (see Tax Law § 1138[a]) as well as case law (see, e.g., Matter of Mera Delicatessen and Emil Mekhail, as Officer, Tax Appeals Tribunal, November 2, 1989) for the proposition that resort to indirect audit methodologies is permissible where a taxpayer fails to maintain and/or make available for review complete, adequate and accurate books and records. It is also clear that where a taxpayer fails to maintain and/or make available such records, the consequences of such failures weigh against the taxpayer (Matter of Meskouris Bros. v. Chu, 139 AD2d 813), and the taxpayer bears the burden of clearly establishing that either the audit method used or its result was erroneous (Matter of Surface Line Operators Fraternal Org. v. Tully, 85 AD2d 858; Matter of Carmine Rest. v. State Tax Commn., 99 AD2d 581).

B. In this case, petitioners admit that sufficient records were not maintained and concede to the propriety of resorting to indirect audit methodologies, even agreeing with the type of methodology employed herein. What petitioners contest is the manner of applying such methodology, specifically arguing for a different allocation of check purchases. Petitioners seek to allocate two additional check purchases to the July test month thereby decreasing the difference between purchases per supplier versus purchases per petitioners' books of account and, in turn, decreasing the margin of error determined. However, petitioners' assertion must be rejected. While it is certainly possible that payments might have been allocated differently, or that a longer test period might have produced a different result, the fact remains that petitioners' books (check register), from which petitioners' representative takes his information, indicate that the additional check purchases which petitioners would reallocate to July 1987 were made in months other than July 1987 (see Finding of Fact "8"). Hence, the argument that such purchases should properly be included in July purchases is unsupported. In fact, petitioners' arguments appear to be inconsistent insofar as they argue that more purchases should be allocated to July, while at the same time arguing that July was a "slow" month. It would seem that purchases would be less rather than more in a slow month (assuming that by a slow month

petitioners mean sales were less during such month as opposed to other months). In the same vein, it is conceivable that cash purchases, which were broken down to a monthly average by the auditor, might have been allocated differently (i.e., that more cash purchases may have occurred during July 1987). However, there is no evidence in the record as to who the cash purchases were made from or of any particular monthly breakdown. In sum, petitioners have failed to show sufficient basis on which to warrant adjustment of the audit results or the assessments derived therefrom.

C. The penalties imposed, including the omnibus penalty, were proper and should remain. There is neither compelling evidence that the assessments are incorrect nor any indication that petitioners made any efforts to meet requisite recordkeeping standards. Accordingly, such penalties are sustained.

D. The petitions of Vito and Maria Salerno d/b/a Frapposa Italian Restaurant and Frapposa Restaurant Corp. are hereby denied and the notices of determination and demands for payment of sales and use taxes due, dated September 20, 1989 and May 8, 1990, respectively, are sustained.

DATED: Troy, New York

ADMINISTRATIVE LAW JUDGE